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Message Text

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TAGS: OECD, ECON, GW
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC): REVIEW OF GERMANY, APRIL 26

1. SUMMARY: AFTER COMPLIMENTING SECRETARIAT'S DRAFT SURVEY, GERMAN DELEGATION UNLEASHED A TIDAL WAVE OF VERBIAGE WHICH STRAYED FAR FROM MAIN POINTS, BUT REVEALED AN UNDERLYING UNWILLINGNESS TO ENGAGE IN ANY REAL DISCUSSION OF GERMAN POLICY. EDRC WAS TOLD IT SHOULD STICK TO WHAT WAS FEASIBLE AND NOT WORRY ABOUT WHAT MIGHT BE DESIRABLE. DELEGATION SEEMED TO BE REHEARSING DRILL FOR UPCOMING OECD MEETINGS WITH PRINCIPAL THRUST TO RATIONALIZE FURTHER POSTPONEMENT OF CONSIDERING STIMULATORY POLICY ACTIONS. NEITHER EDDC CHAIRMAN, NOR HEAD OF GERMAN DELEGATION (DICK OL ECON. MIN.) COULD CONTAIN EXCESSIVELY LONG-WINDED SPEAKERS
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INCLUDING ESPECIALLY NEUTHINGER OF FINANCE AND MATTHES OF BUNDESBANK. JAPAN ANDWITZERLAND BASICALLY SUPPORTED GERMAN POSITION, BUT REMAINDER OF COMMITTEE UNANIMOUSLY URGED ADOPTION OF SECRETARIAT'S DRAFT CONCLUSIONS, WITH MINOR DRAFTING CHANGES. ALL IN ALL, AN UNSATISFACTORY DAY. END SUMMARY

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2. GENERAL PPPROACH OF THE GERMAN DELEGATION: THE GERMANS WELCOMED SECRETARIAT'S DRAFT REPORT DESCRIBING IT AS BALANCED, INTERESTING AND FAIR, WHILE SUGGESTING THAT THEY HAD A FEW CHANGES TO MAKE, PARTICULARLY IN PART III AND IN THE CONCLUSIONS. AFTER THIS DECLARATION, THE GERMAN DELEGATION POURED OUT A SEA OF WORDS RANGING FROM BROAD ECONOMIC PHILOSOPHY TO DETAILS AS TO WHY THERE WERE TOO MANY KINTERGARTENS IN GERMANY, BUT IN THE END, CAST VERY LITTLE LIGHT ON WHAT WAS ACTUALLY HAPPENING IN THE GERMAN ECONOMY OR WHAT THE GERMANS FELT SHOULD BE DONE, IF ANYTHING, TO IMPROVE PERFORMANCE. THEY SEEMED TO HAVE A SEVERE CASE OF FATALISM IN WHICH ALL THEIR FORECASTS WERE SURROUNDED BY RISKS, UNCERTAINTIES AND OTHER DEMANDS WHICH PREVENTED EITHER CORRECTLY APPRECIAT-ING THE ECONOMIC SITUATION OR PRESCRIBING THE NECESSARY MEDICINE WHICH, IN ANY CASE, ALWAYS HAD BAD SIDE EFFECTS. THEY EMPHASIZED INGRAINED LONG-TERM STRUCTURAL PROBLEMS, THE INEVITABILLTY OF WEAKENED INVESTMENT PROPENSITIES, LATENT INFLATIONARY PRESSURES AND THE LACK OF A POLITI-CAL CONSENSUS TO DO ANYTHING AT THE MOMENT. THE BASIC PLOY SEEMED TO BE TO LAY THE GROUNDWORK FOR RATIONALIZING POSTPONEMENT OF CONSIDERATION OF ANY POLICY DECISIONS UNTIL MID-SUMMER AT THE EARLIEST. THEY INTERPRETED EC SUMMIT MEETING IN COPENHAGEN AS REQUIRING ALL EC COUNTRIES TO REASSESS THEIR SITUATION AND TO MAKE POLICY DECISIONS ONLY AFTER SUCH A REASSESSMENT WHEN JOINTLY THE EC COULD
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DECIDE WHO SHOULD DO WHAT. THE HEAD OF THE GERMAN DELE-GATION, AT ONE POINT, SAID THAT THE ROLE OF THE EDRC EXAMINATION WAS NOT TO DETERMINE WHAT WAS DESIRABLE, BUT RATHER WHAT WAS FEASIBLE AND EXPRESSED SOME IRRITATION THAT THE SECRETARIAT SHOULD INSIST ON DISCUSSING WHAT MIGHT BE MORE DESIRABLE THAN CURRENT GERMAN POLICY.

3. FORECAST FOR 1978: THE GERMAN DELEGATION DISCOUNTED THE WEAKNESS IN CURRENT ECONOMIC INDICATORS IN GERMANY, DISMISSING THEM AS TEMPORARY SLUMPS DUE TO RECENT EXCHANGE RATE INSTABILITY AND LABOR MARKET TENSION. THEY CLAIMED THAT THE STIMULATIVE MEASURES OF FALL 1977 HAD NOT YET WORKED THEMSELVES THR.OUGH THE ECONOMY AND THAT IT WAS, THEREFORE, MUCH TOO SOON (AND THAT, IN ANY CASE, THE PARLIAMENT WOULD NOT ACCEPT) TO TAKE NEW STIMULATORY ACTION. THEY ADDED, HOWEVER, THAT SINCE SOME OF THE RISKS (THE EXCHANGE RATE, EXPORT EARNINGS, GROWTH RATE OF FOREIGN TRADE, AND WAGES) IN THE 1978 FORECAST WERE SURFACING, IT WOUL/D BE NECESSARY TO CAREFULLY MONITOR

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EVENTS IN THE NEXT FEW MONTHS, WITHOUT HOWEVER DEFINING WHAT INDICATORS THEY MIGHT CONSIDER AS DECISIVE. GERMANS DID NOT STRONGLY CONTEST SECRETARIAT'S 3 PERCENT GROWTH FORECAST FOR 1978, NOTING THAT 1/2 POINT DIFFERENCES IN FORECAST ARE NEGLIGIBLE, NOR DECLINING PROFILE THROUGH FIRST HALF 1979, ALTHOUGH FRG HAS NO FORECAST BEYOND 1978 AND AT PRESENT SEES NO REASONS FOR DEMAND PESSIMISM. GERMANS DID CONTEST SECRETARIAT PROPOSITION THAT INFLATION RISK WAS MINIMAL BY NOTING THAT PRICES WERE ALREADY CREEPING UP IN THE BUILDING SECTOR. THEY DID NOT ACCEPT THAT THIS PHENOMENON COULD BE THE NORMAL OPERATION OF THE MARKET IN SHIFTING RELATIVE PRICES TO THOSE SECTORS NEEDING ADDITIONAL RESOURCES. ON THE CURRENT ACCOUNT, THEY DISAGREED WITH THE SECRETARIAT FORECAST OF AN NCREASE IN THE SURPLUS, STATING THAT THE 1978 SURPLUS WOULD BE UNCHANGED FROM 1977, SINCE BOTH THE BALANCE OF TRADE SURPLUS AND THE INVISIBLE DEFICIT WOULD RISE SLIGHTLY AND OFFSET EACH OTHER.

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4. ECONOMIC POLICY: THE GERAMN DELEGATION, CITING CN-
CELLON SCHMIDT, AFFIRMED THAT RESTORING A HIGH LEVEL OF
EMPLOYMENT IS THE PRINCIPAL TARGET OF GERMAN ECONOMIC
POLICY. IN THELR DISCUSSION, HOWEVER, THEY NEVER
REFERRED TO THE EMPLOYMENT EFFECTS OF POLICY, ONLY THE
THREAT TO PRICES.

-- FISCAL POLICY: THE NSGREED IN PRINCIPLE WITH
THE SECRETARIAT ANALYSIS THAT SOMEWHAT LARGER GOVERNMENT
DEFICITS WERE NOW NEEDED TO OFFSET THE SURPLUS ON THE
PRIVATE SECTOR FINANCIAL BALANCE, BUT QUICKLY STRESSED
THE LIMITS OF SUCH DEFICITS, NOT ONLY FOR CONSTITUTIONAL
REASONS, BUT ALSO BECAUSE OF THE "SERIOUS THREAT" OF
CROWDING OUT. THE LATTER PARTICULARLY DUE TO THE INA-
BILITY OF THE FEDERAL GOVERNMENT TO CONTROL THE SPENDING
OF THE LAENDER AND MUNICIPALITIES, WHO MIGHT CONTINUE TO
BORROW AFTER PRIVATE DEMAND HAD RECOVERED. THEY CITED
ALSO THE HISTORICAL RELATIONSHIP BETWEEN INFLATION AND
LARGE DEFICITS. FOR 1978, FRG AUTHORITIES EXPECT THE
FISCAL STANCE WILL BE CLOSER TO THE PROJECTIONS THAN
FOR 1977 ALTHOUGH THE DELEGATION EMPHASIZED THE DIFF-
CULTY IN ESTIMATING TAX RECEIPTS AND NOTED THAT VAT
RECEIPTS WERE RISING MUCH FASTER THAN EXPECTED.

-- PENSION FUNDS: THE DELEGATION WELCOMED THE SECRE-
TARIAT'S BALANCED APPROACH TO THIS QUESTION, BUT FELT
THAT GIVEN THE CONSTITUTIONAL LIMITATIONS ON GOVERNMENT
DEFICITS AND THE PUBLIC UNCERTAINTY CREATED BY THE PRE-
CARIOUS FINANCIAL POSITION OF THE PENSION FUNDS, IT
WOULD BE UNDESIRABLE EVEN TEMPORARILY TO SUPPORT THE
FUNDS BY GOVERNMENT TRANSFERS. THEY NOTED THAT UNTIL
THE BASIC FINANCIAL HEALTH OF THE FUNDS WAS RESTORED,
PARTICIPANTS WERE INCREASING THEIR RATE OF SAVINGS
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BECAUSE OF THEIR FEAR THAT THEIR FUTURE INCOMES WOULD
NOT BE SUFFICIENT.

-- MONETARY POLICY: IN RESPONSE TO A U.S. QUESTION,
THE REPRESENTATIVE OF THE BUNDESBANK SAID THAT IT WAS
"UNIMAGINABLE" THAT MONETARY AGGREGATES WOULD BE HELD
TO ZERO GROWTH FOR THE REST OF 198; INSTEAD HE FORESAW
NO SHARP BRAKE IN THE RATE OF MONETARY EXPANSION.
ESSENTIALLY, IN EARLY 1978, THE BUNDESBANK SACRIFICED
ITS MEDIUM-TERM MONETARY AGGREGATES TARGET TO MEET CER-
TAIN CRUCIAL SHORT-TERM (EXCHANGE RATE) CONSIDERATIONS.
HE STRESSED THAT THE MONETARY AGGREGATES TARGETS WERE
ONLY INTERMEDIATE YARGETS AND DO NOT TIE THE HANDS OF
THE BUNDESBANK. BUNDESBANK REP DID NOT DITECTLY ANSWER
QUESTION OF WHETHER ALLOWING OVERSHOOTING OF TARGETS

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CHANGED CREDIBILITY OF BANK"S POLICY, BUT IMPLIED THAT
THIS WAS NOT A MATTER THAT WAS OF PARTICULAR CONCERN.

-- EXCHANGE TE POLICY: FRG DELEGATION REPEATEDLY
EPHASIZED GERMANY'S CLOSE INTEGRATION INTO THE EUROPEAN
ECONOMY TO RE-ENFORCE ARGUMENT THAT GERMANY WAS DEPENDENT
ON EXTERNAL MARKETS AND EXCHANGE RATE STABILITY, AND THAT
GERMANY SHOULD NOT BE CONSIDERED TO HAVE MUCH INDIVIDUAL
POLICY FLEXIBILITY. ON THE OTHER HAND, THE DELEGATION
ARGUED THAT THE RATE OF GROWTH IN GERMANY WAS NOT A FAC-

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TOR IN RECENT EXCHANGE RATE DEVELOPMENTS, NOR WERE THE
INTEREST RTES DIFFERENTIAL SINCE SPECULATIVE CAPITAL
MOVEMENTS WHICH PUT PRESSURE ON THE DM WERE ENTIRELY DUE
TO CONFIDENCE FACTORS, NOT GERMAN GROWTH. IN SUCH A DIS-
TURBED MARKET, THE BUNDESBANK FELT THAT THE "RULES OF
RAMBOUILLET" REQUIRED THAT THEY INTERVENE AND HD DONE
SO TO THE TUNE OF 15 BILLION DM. THE DELEGATION WAS
ASKED, BUT DID NOT REALLY RESPOND, WHETHER THIS INTER-
VENTION HAD ANY REAL EFFECT ON LEVEL EXCHANGE RATE EVEN-
TUALLY REACHED.

-- EMPLOYMENT POLICY: REPRESENTATIVE OF THE MINISTRY

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OF SOCIAL AFFAIRS BASICALLY AGREED WITH THE SECRETRRIAT
NALYSIS OF THE EMPLOYMENT SITUATION, PARTICULARLY THAT
THE LEVEL OF STRUCTURAL UNEMPLOYMENT WAS BELOW THAT
RECORDED IN 1967, THIS REDUCTION DUE TO GOVERNMENT PHO-
GPAMS. THE REST OF THE DELEGATION, PARTICULARLY THE
BUNDESBANK REPRESENTATIVE, SEEMED LESS INCLINED TO ACCEPT
THAT AS MUCH AS HALF OF UNEMPLOYMENT COULD BE CYCLICAL.
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5. CONCLUSIONS: EDRC, WITH THE EXCEPTION OF SWITZER-
LAND AND JAPAN, STRONGLY SUPPORTED THE CONCLUSIONS IN
THE SECRETARIAT'S DRAFT, AGREEING TO MINOR DRAFTING
CHANGES ONLY TO POINT UP SOME OF THE POLICY CONSTRAINTS
IN GERMANY AND TO CLARIFY THE CONCERTED ASPECT OF SUG-
GESTED POLICY ACTION. IT IS DIFFICULT TO DETERMINE THE
GEMAN DELEGATION'S EXACT INTENTIONS WITH RESPECT TO
THE SECRETARIAT'S DRAFT SINCE MOST OF THE SPECIFIC POINTS
WHICH THEY MADE WERE FOUND UNACCEPTABLE BY THE COMMITTEE.
ON THE OTHER HAND, ONE GOT THE FEELING THAT MOST OF THE
PROBLEMS THEY HAD WITH THE DRAFT WERE NOT CLEARLY DELIN-
EATED IN THE COURSE OF THE VERY LONG DEBATE. EDRC, AS
USUAL, WILL HAVE OPPORTUNITY TO APPROVE FINAL TEXT OF
SURVEY WHICH WILL RESULT FROM FURTHER CONTACTS BETWEEN
GERMAN DELEGATION AND SECRETARIAT.
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